2001 Report of the Alternative Form of Regulation for Telephone Utilities

Report to the Utilities and Energy Committee on Actions Taken by The Maine Public Utilities Commission Pursuant to 35-A Chapter 91

In 1994, the Maine Legislature enacted Title 35-A Chapter 91, which authorizes the Public Utilities Commission to adopt an alternative form of regulation (AFOR) for any telephone utility in the State. By Order dated May 15, 1995, the Commission adopted an AFOR for the New England Telephone and Telegraph Company d/b/a NYNEX (now Verizon).[1] Pursuant to 35-A M.R.S.A. § 9105, the Commission is required to provide the Utilities and Energy Committee with an annual report describing the Commission's activities under Chapter 91 and the effectiveness of the AFOR in achieving the objectives of Chapter 91.

On August 30, 2001, the Commission sent the Committee a letter that constituted the Commission's initial response to the AFOR reporting requirement for the year ended September 1, 2001. In that correspondence, the Commission indicated that it would file a full report with the Committee after the Commission had resolved all the issues that had been raised in petitions for reconsideration filed by the Office of the Public Advocate and Verizon. The Commission has now completed its work and on October 12, 2001, issued its Order Granting Requests for Reconsideration and Order Granting and Denying Modifications. The Commission now submits its full report to the Committee concerning activities related to the AFOR.

1. 2000 Annual Filing Under the AFOR

Under the AFOR that was in place from 1995 through 2000, Verizon filed a request for rate change each year on September 1, with any resulting rate changes effective on December 1. Because the Commission extended the termination date of the Verizon AFOR from November 30, 2000, until May 29, 2001, the Commission required Verizon to make its annual AFOR filing on December 1, 2000, with any required rate changes to become effective on January 1, 2001. As a result of the December 1, 2000, AFOR filing and pursuant to the AFOR pricing rules, Verizon filed and the Commission approved various rate changes that resulted in a net annual revenue reduction of $5.5 million. Those rate reductions mainly applied to long distance rates and became effective on January 1, 2001.

2. The New AFOR

Through the orders issued by the Commission on May 9, 2001, June 25, 2001, and October 12, 2001, the Commission extended the Verizon AFOR for an additional

[1] In 1997, NYNEX merged with Bell Atlantic and began providing service under the Bell Atlantic name. In 2000, Bell Atlantic merged with GTE Corporation and changed its corporate name to Verizon, which is the name under which it currently conducts business.

five years and ordered several significant changes to be made to the pricing rules and service quality index (SQI) mechanism. To offset a portion of the revenue loss to Verizon caused by the reduction in in-state access rates mandated by 35-A M.R.S.A. § 7101-B, the Commission allowed Verizon to increase its basic exchange rates by $1.78 per month per access line, with Lifeline rates exempted from the increase.

Under the new AFOR, Verizon will not be able to raise rates for basic exchange service (beyond the initial increase of $1.78), directory assistance or operator service during the term of the plan, but the Company may seek permission for rate increases under certain circumstances. For example, in 2003 Verizon will be required again to adjust its intrastate access rates to levels that are at or below the federal rates. It is anticipated that the mirroring of federal and state access rates will result in an additional loss of revenue to Verizon, but the magnitude of the reduction is uncertain at this time. The new AFOR does not preclude Verizon from seeking an increase to its basic rates to offset any future access rate reductions, if it believes such an increase is justified and is of sufficient magnitude to warrant the administrative costs involved. Verizon also may not increase the rates it charges for operator assistance or directory assistance, unless Verizon can show a cost basis for such a change or that either of these services has become competitive.

Verizon has pricing flexibility for all other retail services, such as toll and optional features marketed as Custom Calling Services and PhoneSmart Services. The Commission, however, will open a proceeding to determine if certain optional services have the characteristics of basic service, i.e., they are used by a substantial number of customers who consider them a necessity and no competition exists for them. If the Commission finds the services possess such characteristics, it may decide to subject them to some type of pricing restrictions. As mentioned above, the Commission will continue to set Verizon's intrastate access rates according to the statutory mandate that requires intrastate rates to mirror interstate rates, and its wholesale service rates, which it charges to competitors who use parts of the Company's system, will be established in accordance with guidelines set forth in the federal TelAct.

Verizon had also asked the Commission to allow an additional increase to its basic service rates to account for the loss of in-state long distance (toll) revenue, because toll rates are likely to continue their recent downward trend due to declining access rates and increasing competition. The Commission declined to allow Verizon any additional increase to basic rates, thus requiring the Company to offset any toll revenue loss with productivity gains. In the initial AFOR plan, Verizon's rates were changed each year according to an index that considered inflation, productivity and exogenous factors. In the new AFOR, no index mechanism exists, and the Commission found that any cost increases due to inflation should be offset entirely by future productivity gains.

To ensure that ratepayers will actually receive some of the benefits of toll rate reductions, as Verizon asserted would happen, the Commission ordered that Verizon demonstrate that its toll revenues or its toll rates actually are lower by $19.8 million, the minimum toll loss estimated by the Company. Verizon has two years from the date of implementation of the new AFOR in which to make this showing. The Company must show that its recorded toll revenues actually decrease from its reported 2000 toll revenues, or it must show that any toll rate reductions that it implements produce $19.8 million less revenue, using billing units from 2000. If Verizon is unable to make the required demonstration within the allowed time period, the Commission may order the Company to reduce certain rates in order to attain the required revenue reduction.

The Commission also made several modifications to the SQI mechanism applicable to Verizon. Based on its experience with the initial SQI, the Commission added six new metrics, changed four others and kept five of the metrics from the initial AFOR. The SQI in the new AFOR will consist of 15 metrics that set standards for the Company's performance in the areas of customer service, service reliability and customer satisfaction. The metrics are:

Customer Service

1. Premise Installations: Percent Appointments not Met for Company Reasons
2. Mechanized Installations: Percent Appointments not Met for Company Reasons
3. Premise Repairs: Percent Appointments not Met for Company Reasons
4. Mechanized Repairs: Percent Appointments not Met for Company Reasons
5. Held Orders: Average Delay Days
6. Business Office Calls: Percent Answered over 20 Seconds
7. Repair Service Calls: Percent Answered over 20 Seconds

Service Reliability

8. Customer Trouble Reports: Rate per 100 Lines
9. Repeat Trouble Reports: Rate per 100 Lines
10. Percent Troubles not Cleared within 24 Hours – Residential Customers
11. Percent Troubles not Cleared within 24 Hours – Business Customers
12. Dial Tone Speed: Percent over 3 Seconds

Miscellaneous

13. Percent Blocked Calls
14. Service Outage

Customer Satisfaction

15. MPUC Complaint Ratio

The Company's performance in each category will be measured against baseline targets that are based on the Company's recent historic performance, as was the case in the initial AFOR. Should the Company fail to meet any of the metric baselines on an annual basis, it will be required to provide a rebate to customers of up to $1.135 million per metric, with an annual cap of $12.5 million. The Commission believes the SQI mechanism provides Verizon with a strong incentive to continue to provide high quality service to all of its customers, and that the metrics included in the new AFOR establish appropriate performance standards in the areas of service quality that are most important to customers. The Commission will continue to monitor service quality closely, both in areas covered by the AFOR SQI mechanism and in any area that the Commission finds needs attention.

The Company also agreed to a change in its method of operation regarding credits given to customers who lose their basic service for more than 24 hours. Because the Company cannot readily identify all customers who lose service during a service interruption, affected customers must still contact the Company to request a rebate on their basic service charge. The Company has agreed to take several additional customer education and outreach steps to more widely inform customers about the availability of the credit. Thus, customers should be more aware of the existence of the credit and the minimal steps they must take to obtain it.

3. Future AFOR Activity

On November 9, 2001, the OPA filed a Notice of Appeal from the Commission's AFOR decision with the Maine Law Court. The OPA challenged several aspects of the Commission decision. A schedule for hearing the case before the Law Court will be established shortly. The Commission will inform the Committee of the outcome of this proceeding.